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Before the
Federal Communications Commission
WASHINGTON, DC 20554

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In the Matter of Application of Verizon New Jersey, Inc., BellAtlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a/ Verizon Enterprise Solutions), Verizon Global Networks, Inc., and Verizon Select Services, Inc., for Authorization to Provide In-Region InterLata Services in New Jersey	)	CC Docket No. 01-347

REPLY COMMENTS OF QWEST CORPORATION

Roy Hoffinger
Vice President, Chief Counsel,
Federal and State Regulation
QWEST CORPORATION
1801 California St.
Denver, CO 80202
(303) 992-1400

William T. Lake
Jonathan J. Frankel
William R. Nifong
WILMER CUTLER & PICKERING
2445 M St., N.W.
Washington, DC 20037
(202) 663-6000

Attorneys for Qwest Corporation

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REPLY COMMENTS OF QWEST CORPORATION

Qwest Corporation ("Qwest") submits these reply comments in response to the Commission's Public Notice in this proceeding. These comments respond to a new argument raised by several CLEC commenters opposing the Verizon New Jersey entities' (collectively, "Verizon's") section 271 application: the argument that granting Verizon's application would disserve the "public interest" under 47 U.S.C. § 271(d)(3)(C) unless CLECs can earn a significant profit by serving residential customers through the "UNE platform." As discussed below, that argument is wrong on the law and is unsupported by the facts, and it should be rejected.

INTRODUCTION AND SUMMARY

Relying on the D.C. Circuit's recent opinion in *Sprint Communications Co. v. FCC*,[1] several CLECs — including AT&T, Z-Tel Communications ("Z-Tel"), and WorldCom — have asserted that, to satisfy the public interest standard of 47 U.S.C. § 271(d)(3)(C), Verizon must show not just that its UNE rates are at or below TELRIC, but also that those rates would enable the CLECs to earn substantial profits by offering residential service through the UNE platform. That argument is flawed on multiple levels.

First, Congress anticipated that UNE-based entry strategies, with their "bottom-up" cost structures, may not always be the most appropriate method of entry in every circumstance, especially where retail prices are held artificially low. Congress thus

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1 274 F.3d 549 (D.C. Cir. 2001).

provided an alternate method of entry: resale of ILEC retail services under 47 U.S.C. §§ 251(c)(4) and 252(d)(3). Because the Act entitles a CLEC to purchase such services for resale at wholesale rates below retail prices, it guarantees a positive margin between the price at which the CLEC resells these services and the rate that it pays the ILEC. But this is the *only* context in which Congress expressed any concern for CLEC "margins" at all. Where existing retail residential service rates make it difficult for CLECs to compete for some residential customers through the UNE platform, a CLEC's recourse (so long as it makes no investment in facilities of its own) is to enter the market through resale, not to challenge legitimate cost-based UNE prices for failing to produce a similar or greater margin.

Once a Bell company has complied with the requirements of the section 271 checklist, including the requirement that rates be based on cost, it would be unlawful to order further reductions in those rates in an effort to gin up greater UNE platform competition. Such reductions would violate not just the cost standard of 47 U.S.C. § 252(d)(1), but also Congress's prohibition on "extend[ing] the terms used in the competitive checklist," 47 U.S.C. § 271(d)(4). Such reductions would also thwart the federal policy of encouraging CLECs to deploy their own facilities. Moreover, denying a section 271 application until ubiquitous platform-based local competition has developed would undermine, not advance, the critical public interest in full and fair *long-distance* competition.

Finally, the CLECs' arguments fail on the facts as well. AT&T simply asserts the existence of a price squeeze without providing any factual support at all. Z-Tel makes the unrealistic assumption that the *only* revenue a CLEC would receive from serving residential customers through the UNE platform is the state-set price for basic local calling. Z-Tel ignores all of the potential revenues from the additional services the CLEC would provide to the same customer using the same UNEs — including vertical features, toll revenues, and savings on (or receipt of) access charges — which no prudent business would ever do. WorldCom does concede, unlike Z-Tel, that some of these other sources of revenue must be considered, but it inexplicably leaves out of the comparison several of the largest sources, including toll services attributable to purchase of the platform. Yet even WorldCom's seriously incomplete margin analysis demonstrates that CLECs' margins on the UNE platform in the New Jersey residential market are positive; the profits simply are not high enough for WorldCom's liking. In short, the "price squeeze" argument raised by the CLEC commenters provides no lawful basis for denying Verizon's section 271 application.

I. WHERE UNE RATES ARE ALREADY BASED ON TELRIC, IT WOULD BE INAPPROPRIATE AND UNLAWFUL TO REDUCE THEM FURTHER IN AN ATTEMPT TO ENGINEER SOME GREATER LEVEL OF UNE PLATFORM COMPETITION.

The question presented here is whether, once a Bell company complies with the pricing requirements of the competitive checklist and sets its rates at cost, the "public interest" standard of section 271 independently conditions long-distance entry on the Bell company's willingness to lower its rates *still further* simply to produce more widespread residential competition through the UNE platform. In *Sprint v. FCC*, the D.C. Circuit did *not* endorse that reading of section 271 on the merits. To the contrary, the court left in place the FCC's section 271 authorization for Kansas and Oklahoma, while remanding to the Commission for more detailed "consideration" of the issue.[2] The D.C. Circuit expressed concern merely about what it perceived as a "brush-off" of AT&T's price squeeze claim,[3] and it remanded so that the Commission could reconsider and either "pursue [AT&T's] price squeeze claim, or at the very least explain why the public interest does not require it to do so."[4]

Notably, the court observed that the Commission could well reaffirm its existing position on remand, and indeed it pointed the way to that outcome. As it explained, the lack of a market share requirement in the section 271 inquiry could "reflect a recognition" that, even if UNE rates are based on TELRIC, "the residential market may not be attractive to competitors" choosing to enter through the UNE platform.[5] The court also acknowledged the possibility that state-mandated retail prices beyond the Bell company's control could be responsible for dampening CLECs' prospects for market entry, especially since states "have historically set relatively low residential rates . . . allowing the incumbent monopoly to make it up in other aspects of their business."[6] In both situations, it would *disserve* the public interest to deprive consumers of greater long-

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2 *Sprint v. FCC*, 274 F.3d at 555.

3 *Id.* at 554.

4 *Id.*

5 *Id.* at 556.

6 *Id.* at 555. The D.C. Circuit did not rule on this argument because it was not explicitly raised in the *SBC Kansas/Oklahoma Order* itself. *See* Memorandum Opinion and Order, *Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, 16 FCC Rcd 6237 (2001) ("SBC Kansas/Oklahoma Order").

distance competition simply because CLECs, through no fault of the BOC applicant, find the platform an inapt business model for widespread entry into the residential market.

Indeed, the UNE platform was never intended as an appropriate entry strategy in all settings. Precisely because the 1996 Act specifies "cost" as the basis for UNE prices, the platform can be an effective entry vehicle only for customers that would otherwise provide an incumbent LEC with revenues that, in the aggregate, are *at or above cost.* Congress neither designed nor expected a cost-based platform to help CLECs recruit customers — including most residential customers — whom an incumbent LEC serves at *below-cost* rates through various subsidy mechanisms. For such customers, Congress gave CLECs a separate entry option with a different pricing scheme: resale of an incumbent LEC's retail services, for which CLECs pay a wholesale rate stepped down from the incumbent's retail rate, even where Qwest's retail rate for particular customers is below cost.[7] As the Commission has explained, "the different pricing regimes for these two entry options ensure that resale will be a more attractive entry option than network elements" for such below-cost customers.[8] While some CLECs also disparage the margins allowed for resale of an ILEC's finished services, those are the only margins that Congress guaranteed for CLECs that make no investment in facilities of their own.[9]

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7 *See* 47 U.S.C. §§ 251(c)(4), 252(d)(3).

8 Petitioners' Reply Brief at 40 n.27, *FCC v. Iowa Utils. Bd.*, 525 U.S. 366 (1999) (No. 97-826 and consolidated cases).

9 AT&T refers to the absence of similar margins in the UNE context as a "price squeeze," but that antitrust term is inapt. A true price squeeze claim can arise only where a firm charges more than a "fair price" for an essential input. *See United States v. Aluminum Co. of America*, 148 F.2d 416, 437-38 (2d Cir. 1945). Here, ILECs can hardly be said to sell their UNEs at an "unfair" price for UNEs, because the prices they charge are regulated and are based on a strikingly pro-competitor TELRIC methodology. *See*

Nothing in the Act requires that the various modes of entry all yield equal operating profits (or, indeed, *any* profits) in all possible circumstances and for all customers served.

In any event, the magnitude of resale margins provides no excuse for illegally driving the price of the UNE platform down below cost to give CLECs even bigger margins. Under the 1996 Act, only the prices of finished services offered for resale are lawfully determined using a "top down" inquiry with guaranteed margins; UNE rates must be determined on a "bottom up" *cost* basis.[10] There is no reason to expect that these very different formulas would yield equally large profits in every instance.

Nor would it be lawful, as AT&T, Z-Tel, and WorldCom propose, to use the "public interest" standard as a pretext for erasing the express and specific statutory distinction between these two pricing formulas by setting UNE prices with reference to retail rates as well. Construing that standard to create additional pricing-related obligations on top of those found in the section 271 checklist would violate 47 U.S.C. § 271(d)(4), which bars the FCC from "extend[ing] the terms used in the competitive checklist." Here, the approach proposed by the CLECs would not only "extend," but indeed *supplant*, a critical term of the checklist: the requirement that rates for network

Town of Concord v. Boston Edison Co., 915 F.2d 17, 29 (1st Cir. 1990) (Breyer, J.) (observing that "'normally' a price squeeze will not constitute an exclusionary practice in the context of a fully regulated monopoly"). In any event, the UNE platform is not remotely an "essential input" for CLEC market entry, because CLECs may alternatively enter either through resale or through the deployment of their own alternative facilities, whether or not combined with individual Verizon UNEs. *See, e.g.,* Sixth Report, *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, FCC No. 01-192 (rel. July 17, 2001), at 32 (discussing rise of wireless technology as a substitute for, and not just a complement to, landline telephony).

[10] *Compare* 47 U.S.C. § 252(d)(1) *with* 47 U.S.C. § 252(d)(3).

elements be based on "cost" rather than on some other criterion, such as potential profitability under current market conditions.

Pricing UNEs below TELRIC would also undermine the core statutory objective of encouraging CLECs to invest in their own facilities. As the Commission recently observed, "[t]hrough its experience over the last five years in implementing the 1996 Act, the Commission has learned that only by encouraging competitive LECs to build their own facilities or migrate toward facilities-based entry will real and long-lasting competition take root in the local market."[11] Setting rates *below* TELRIC, when TELRIC itself has been criticized for discouraging carriers from building their own competing facilities, would undermine that federal policy. No carrier would ever build facilities of its own, at cost, if it could lease them instead at rates below cost.

The CLEC commenters attempt to characterize what they are seeking here not as below-cost UNE rates, but rather as UNE rates set "at the low end of the range" of TELRIC reasonableness.[12] This is nonsense. TELRIC mandates an even-handed calculation of what it would cost today to replace the functions of the existing network using currently available technology (and taking existing wire centers for granted). Each

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[11] *Fourth Report and Order, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 16 FCC Rcd 15435, 15437 ¶ 4 (2001); *see also Notice of Proposed Rulemaking, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Notice of Proposed Rulemaking, CC Docket No. 01-339, FCC 01-361 ("UNE Triennial Review NPRM"), Separate Statement of Chairman Michael K. Powell at 2 (rel. Dec. 20, 2001) (stressing the FCC's "ongoing commitment to the promotion of facilities-based competition"); *id.* ¶ 24 (seeking comment "on whether we should modify or limit incumbents' unbundling obligations going forward so as to encourage incumbents and others to invest in new construction").

[12] *See, e.g.*, Comments of AT&T Corp., Comments Request, filed in CC Docket 01-347 on Jan. 14, 2002 ("AT&T Comments") at 45-46.

state must conduct that inquiry faithfully and without bias against incumbent LECs. Of course, as the FCC has observed, different states conducting that inquiry in good faith may produce varying answers. But the existence of such variation cannot lawfully justify systematic bias against ILECs whenever difficult judgment calls are required.

More generally, it is *never* appropriate to ratchet any state's UNE prices down simply to reflect the lowest cost-adjusted UNE rates adopted by some *other* state that has received section 271 approval from the FCC. Among other considerations, the Commission never finds in the section 271 context that rates are *no lower than* what TELRIC requires, because Bell companies do not use section 271 proceedings as forums for complaining to the Commission about erroneous state commission decisions that result in rates below cost. Instead, in approving section 271 applications, the Commission finds only that UNE rates are *no higher than* what TELRIC requires. There is thus no basis whatsoever for contending, as some CLECs have in this proceeding,[13] that the low end of TELRIC "reasonableness" is defined by the lowest rates adopted by any state where section 271 authorization has been granted.

II. WHERE UNE RATES ARE BASED ON TELRIC, IT WOULD THWART THE PUBLIC INTEREST TO DENY SECTION 271 AUTHORIZATION SIMPLY BECAUSE CLECS ARE NOT USING UNE PLATFORMS TO SERVE LARGE NUMBERS OF RESIDENTIAL CUSTOMERS.

According to AT&T, even where rates are based on TELRIC, if platform-based residential competition still does not develop, "that would simply establish that the

[13] *See, e.g.*, Comments of Z-Tel Communications, Inc., Comments Request, filed in CC Docket 01-347 on Jan. 14, 2002 ("Z-Tel Comments") at 7-9.

Section 271 application must be denied."[14] That is so, AT&T contends, because "it would have been shown that the local market is not open to competition, and BOC entry in those circumstances would patently disserve the public interest by enabling the BOC to remonopolize the *long-distance market* in that State."[15] That absurd proposition, which other CLEC commenters endorse, flies in the face of long-standing FCC determinations and the interests of consumers.

A. Keeping Bell companies out of the long-distance market after they have complied with the checklist would do nothing to increase local competition and much to harm long-distance competition.

The CLEC commenters are effectively arguing that the public interest test should be read to keep the Bell companies out of the long-distance market even after section 271 has fulfilled its purpose of inducing the Bell companies to do *everything they could reasonably be expected to do* to open their local markets to competition, simply because CLECs have not in fact entered the market using a particular entry strategy. That could make sense only if Congress intended section 271 not to promote consumer welfare, but rather as a protectionist gift for incumbent long-distance carriers. To the contrary, Congress "desire[d] to condition approval solely on whether the applicant has opened the door for local entry through full checklist compliance, not on whether competing LECs actually take advantage of the opportunity."[16] As the Commission has recognized many

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14 AT&T Comments at 46.

15 *Id.* (emphasis added).

16 Memorandum Opinion and Order, *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York*, 15 FCC Rcd 3953, 4163 ¶ 427 (1999), *aff'd sub nom. AT&T Corp. v. FCC*, 220 F.3d 607 (D.C. Cir. 2000) ("Bell Atlantic New York Order").

times, Congress squarely *rejected* proposals to condition section 271 authorization on CLECs' having achieved a certain level of market penetration on the ground: "Congress specifically declined to adopt a market share or other similar test for BOC entry into long distance, and we have no intention of establishing one here."[17]

The appropriate point of reference for determining the "public interest" is consumer welfare — whether "BOC entry into the long distance market will benefit consumers and competition"[18] — not the particular business interests of CLECs. Although consumer welfare and CLECs' business interests sometimes coincide, they often do not. Because, as discussed above, it would be unlawful to *decrease* TELRIC-based rates as a means of generating greater UNE platform competition, the principal

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[17] *Id. See also* Memorandum Opinion and Order, *Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 To Provide In-Region, InterLATA Services in Arkansas and Missouri*, 16 FCC Rcd 20719, 20782 ¶ 126 (2001) ("SBC Missouri/Arkansas Order"); Memorandum Opinion and Order, *Application of Verizon Pennsylvania Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc. for Authorization To Provide In-Region, InterLATA Services in Pennsylvania*, 16 FCC Rcd 17419, 18558-59 ¶ 126 (2001); Memorandum Opinion and Order, *Application of Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions) And Verizon Global Networks Inc., For Authorization to Provide In-Region, InterLATA Services in Massachusetts*, 16 FCC Rcd 8988, 9118-19 ¶ 235 (2001); *SBC Kansas/Oklahoma Order* at 6375-76 ¶ 268; Memorandum Opinion and Order, *Application by SBC Communications Inc., Southwestern Bell Telephone Company, And Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 To Provide In-Region, InterLATA Services in Texas*, 15 FCC Rcd 18354, 18558-59 ¶ 419 (2000) ("SBC Texas Order"). *See also Sprint v. FCC*, 274 F.3d at 556 (acknowledging that the FCC has read section 271 "to require only a minimal volume of competition" before an application can be approved).

[18] *SBC Missouri/Arkansas Order* at 20782 ¶ 126; *SBC Kansas/Oklahoma Order* at 6375-76 ¶ 268; SBC Texas Order at 18558-59 ¶ 419.

alternative would be to *increase* retail end user rates. There is little question that eliminating implicit cross-subsidies, replacing them with explicit funding mechanisms, and rebalancing end user rates are all desirable goals. But, in the meantime, competitors will have little incentive to serve consumers whose retail rates are capped at artificially low levels.

The question here, then, is whether it would make sense, as the CLEC commenters contend, to penalize the BOCs, and keep them from competing in the long-distance market, during the interim period before those rates are raised. It would not, and it would be equally unreasonable to deny consumers the benefits of enhanced long-distance competition that Congress specifically anticipated. By hypothesis, during this interim period, pricing UNEs at TELRIC will not produce residential competition through the UNE platform, and withholding section 271 authorization would not generate greater competition in the *local* market. It would merely constrain competition — and produce higher consumer prices — in the long-distance market, resulting in a net *decrease* in consumer welfare. This is precisely the evil about which the D.C. Circuit warned when it observed, in upholding the Commission's New York section 271 order, that "setting the bar too high [for section 271 approval] would . . . deprive the ultimate beneficiaries of the 1996 Act — American consumers — of a valuable source of price-reducing competition in the long-distance market."[19]

Indeed, as demonstrated by the recent success of the "big three" IXCs (AT&T, Sprint, and MCI WorldCom) in raising their long-distance rates, the long-distance market

[19] *AT&T Corp. v. FCC*, 220 F.3d 607, 633 (D.C. Cir. 2000) (internal quotations omitted).

today remains so concentrated that Bell company entry remains necessary to drive consumer rates down to cost. In the absence of greater BOC competition in the long-distance market, AT&T has recently raised its monthly universal service line-item fee for its residential customers from 9.9% to 11.5%[20] — and this is after it raised the charge from 8.6% in 2001. It appears that AT&T pays only about 60% of this amount into the federal universal service fund, apparently pocketing the rest.[21] In addition, *all* of the "big three" are raising their basic rates in lockstep starting February 1. AT&T's twenty-three million basic residential customers, for example, will now pay 35 cents a minute — 17% more — for daytime calling.[22] AT&T has similarly increased its basic evening rates from 25 to 29.5 cents a minute.[23] Fully 42 percent of AT&T's subscribers, 60 percent of Sprint's subscribers, and 45 percent of MCI WorldCom's subscribers will be hit by these basic rate hikes — and a new study suggests that it will be the poorest and least educated customers who will suffer the most.[24]

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[20] *See AT&T Increases Universal Service Fee Because of 'Lag' Problem*, Communications Daily, Jan. 3, 2002, Vol. 22, No. 2 ("*AT&T Increases Fee*").

[21] *See Survey Finds Long Distance Rates and Fees Creeping Up*, Consumer Action News, *at* http://www.consumer-action.org/Library/English/Newsletter/NL-I-23_EN/NL-I-23_EN.html (Sept. 2001); *see also Dingell Asks FCC to Open AT&T Books on Universal Service Fees*, Communications Daily, Jan. 9, 2002, Vol. 22, No. 6.

[22] *See AT&T Increases Fee.*

[23] *Id.*

[24] *See Study Suggests IXCs Gouge Poor Customers*, TR Daily, Jan. 28, 2002 (reporting on forthcoming study by Jerry A. Hausman and J. Gregory Sidak, entitled *Do Long-Distance Carriers Price Discriminate Against the Poor and the Less-Educated?*) (abstract available online from the Social Science Research Network *at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=296368#Paper Download).

B. AT&T's concerns about Bell company "remonopolization" of the long-distance market are untenable and flatly inconsistent with established FCC findings.

As discussed, denying long-distance entry when a Bell company has complied with the competitive checklist would thwart, not serve, the public interest. AT&T contends, however, that Bell company entry into the long-distance market in these circumstances would disserve consumer welfare over the long term because it would somehow "enabl[e] the BOC to remonopolize the long-distance market."[25]

Although unelaborated and obscure, AT&T's apparent argument is the time-worn claim that, without robust UNE-P competition in the local market, a dominant ILEC could manipulate its own access charges and the long-distance rates of its IXC affiliate to drive unaffiliated IXCs out of the long-distance market. This is nonsense, as the Commission has already determined. In findings specifically affirmed by the Eighth Circuit, the Commission has repeatedly explained that equal access obligations, together with existing structural safeguards, "provide adequate safeguards against any effort by an incumbent to obtain an unfair competitive advantage in the long-distance market by discriminating against unaffiliated IXCs or by improperly allocating costs or assets between itself and its long-distance affiliate."[26]

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[25] AT&T Comments at 46.

[26] *Supplemental Order Clarification, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd. 9587, 9597-98 ¶ 20 (2000) ("Supp. Order Clar."); accord *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 548 (8th Cir. 1998) (rejecting same "price squeeze" argument), *affirming First Report and Order, Access Charge Reform*, 12 FCC Rcd 15,982, 16101-04 ¶¶ 277-82 (1997); *see also Second Report and Order, Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, 12 FCC Rcd 15,756, 15811-12 ¶ 97 (1997) ("LEC Non-Dominant Order") ("[G]iven the presence of existing

Indeed, the general rule is that ILECs, with the exception of the BOCs, are perfectly free to compete in the long-distance market so long as they comply with those equal access obligations and certain structural separation requirements. The FCC has repeatedly observed that, "for over ten years, . . . independent (non-BOC) incumbent LECs have been providing in-region, interexchange services on a separated basis with *no substantiated complaints* of a price squeeze" in the long-distance market.[27] Moreover, because the relatively less rigorous regulations applicable to non-BOC ILECs effectively preclude such anticompetitive behavior already, the same conclusion applies *a fortiori* to any Bell company that has complied with the extraordinary requirements of the section 271 checklist and the unusually rigorous separate affiliate and joint marketing restrictions of section 272.

AT&T also obliquely suggests that, all other things being equal, consumers would prefer to purchase local and long-distance services from the same company, and that once a Bell company receives section 271 authorization, it would have an advantage in providing consumers with both services unless unaffiliated IXCs could provide ubiquitous residential competition through the UNE platform.[28] Missing from this

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interexchange carriers, including such large well established carriers as AT&T, MCI, Sprint, and LDDS [now part of WorldCom], we find that the cost structure, size, and resources of the BOC interLATA affiliates are not likely to enable them to raise prices above the competitive level," notwithstanding their "brand identification" and "possible efficiencies of integration" and in light of the fact that "their lack of nationwide facilities-based networks would appear to put them at a disadvantage relative to the four largest interexchange carriers.").

27 *Access Charge Reform* at 16101-02 ¶ 279 (emphasis added); *accord Southwestern Bell*, 153 F.3d at 548; *Supp. Order Clar.* at 9597-98 ¶ 20.

28 Although AT&T cites Commission orders for this proposition, in fact the Commission has explained that this concern arises "[a]bsent checklist compliance." *Bell*

argument is any identification of a harm to the *public interest*, as distinguished from harm to the market shares of the incumbent long-distance carriers. If consumers do in fact consider themselves better off if they have the option of purchasing local and long-distance services from the same carrier, that is a reason for *granting* a section 271 application, not for denying it.

There is, moreover, no scenario under which consumers could be worse off in the long run if the benefit of dealing with one company is what persuades them to choose a Bell company as their long-distance carrier. AT&T's apparent argument is that, by offering consumers a product they prefer, Verizon might use this advantage to drive unaffiliated IXCs out of the long-distance market altogether and might then raise and sustain consumer long-distance rates above cost. That too is nonsense, for reasons the Commission has already identified. In the words of the Supreme Court,

> The success of any predatory scheme depends on *maintaining* monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain. Absent some assurance that the hoped-for monopoly will materialize, *and* that it can be sustained for a significant period of time, "[t]he predator must make a substantial investment with no assurance that it will pay off."[29]

Here, the Commission has specifically determined that no Bell company (or any other incumbent LEC) could possibly succeed at such a scheme: "'Even in the unlikely event that [LECs' interexchange affiliates] could drive one of the three large interexchange carriers into bankruptcy, the fiber-optic transmission capacity of that carrier would

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Atlantic New York Order at ¶ 428. Of course, the public interest dispute at issue here would not even arise unless Verizon *has* satisfied the checklist.

[29] *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986) (quoting Frank H. Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. Chi. L. Rev. 263, 268 (1981)).

remain intact, ready for another firm to buy the capacity at a distress sale and immediately undercut the [affiliates'] noncompetitive prices.'"[30]

In sum, there is no respect in which consumers would be better off in *either* the local market *or* the long-distance market if BOCs were kept out of the latter market until TELRIC-based rates produce widespread residential competition based on the UNE platform. To the contrary, keeping BOCs out of the long-distance market until such competition develops would serve only to deprive consumers of additional, price-reducing competition in the long-distance market. And it would be unfair to the BOCs themselves, because it would penalize them for regulatory conditions beyond their control, such as delays in the rebalancing of retail rates or, as the D.C. Circuit explicitly recognized, a state policy of keeping residential rates at very low levels.[31]

III. IN ANY EVENT, THERE IS NO FACTUAL PREDICATE FOR THE CLECS' UNE-PLATFORM "PRICE SQUEEZE" CLAIM.

Even if some kind of margin analysis *were* relevant to section 271's public interest test, the CLECs' arguments would still fail on the facts. None of the commenters has demonstrated that Verizon's UNE rates in fact preclude a CLEC from earning positive margins by using UNE platforms to provide residential service in New Jersey. AT&T, for example, merely asserts that Verizon's UNE rates "effect a price squeeze that prevents UNE-based competitors from earning sufficient margins to provide local service economically" without providing any supporting factual detail at all; AT&T never bothers to explain what measure of wholesale cost it is using, what measure of potential

30 *Access Charge Reform* at 16102-03 ¶ 281 (quoting Daniel F. Spulber, *Deregulating Telecommunications*, 12 Yale J. Reg. 25, 60 (1995)).

31 *See Sprint v. FCC*, 274 F.3d at 555.

retail revenue it is comparing that cost against, or what "margin," even in its view, is "sufficient."[32] Z-Tel likewise makes no serious attempt to determine what retail revenues a UNE-platform-based CLEC could expect to receive. Instead, Z-Tel compares the cost of UNEs against the $8.19 price for basic residential service set by the New Jersey BPU.[33] But this is a specious comparison: no prudent business deciding whether to enter the local market would look only at the revenues for basic local service standing alone and ignore all other revenues associated with the same UNEs, including vertical features, toll revenues, and savings on (or receipt of) access charges.[34] A prudent CLEC would look instead at *all* of the revenues it could expect to earn by serving a given residential customer over the same UNE platform — and, indeed, it would seek to maximize those revenues by targeting the customers most likely to buy these additional services.

Z-Tel's simple comparison of UNE platform prices and basic 1FR rates has been soundly rejected by the state regulators who have considered it. In Qwest's region, for example, AT&T raised the identical argument in the consolidated proceeding considering Qwest's section 271 applications in Idaho, Iowa, Montana, New Mexico, North Dakota, Utah, and Wyoming. The Facilitator presiding over the consolidated proceeding found that AT&T's comparison between UNE platform prices and basic residential rates was so "simplistic" and "incomplete" as to "render it of inconsequential value in assessing the

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32 AT&T Comments at 42.

33 Z-Tel Comments at 2 & n.5, 4-5.

34 AT&T's argument that the FCC should not consider "profits [the CLEC] obtains in other markets — such as local services to large businesses, or long-distance services," AT&T Comments at 46, misses the point. The additional revenues in question are those derived from gaining access to the UNE platform, no matter what "market" is at issue.

state of local markets in Qwest's local exchange serving areas."[35] AT&T's price squeeze argument, he added,

> failed to persuade for many reasons. First, it did not recognize that local rates consist of much more than the basic monthly charge for service. Vertical features and intrastate toll revenues must be considered . . . . AT&T conceded that it had made no effort to measure or to take account of such other revenues. Second, AT&T's analysis did not consider the existence of resale as an option for certain service classes that do not lend themselves to economical competition through the use of UNEs. Third, AT&T did not provide any evidence of business rates; it did not even provide its simple comparison of basic rates for such service. Fourth, AT&T did not address the issue of what "subsidies" might be available to it in the event that it should serve qualifying residential lines through facilities-based competition.[36]

Indeed, AT&T itself conceded on cross-examination that its price squeeze argument bore little resemblance to how an actual would-be entrant would make its entry decision. When asked whether "a business [would] not look at all the revenue it would expect to capture from that customer against all of the costs that would be involved in serving that customer and make the judgment *on that basis* rather than comparing simply the UNE-P rate against the 1FR rate,"[37] AT&T's witness confessed that she "would expect [the business] would look at the additional services" — a proposition the Facilitator volunteered was "self-evident."[38]

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[35] Facilitator's Report on Public Interest (Oct. 22, 2001) at 5-6, *In the Matter of the Investigation into Qwest Corporation's Compliance with § 271 of the Telecommunications Act of 1996*, Seven State Collaborative Section 271 Workshops.

[36] *Id.*

[37] Transcript of Workshop Proceedings, *In the Matter of the Investigation into Qwest Corporation's Compliance with § 271 of the Telecommunications Act of 1996*, Seven State Collaborative Section 271 Workshops, June 26, 2001, at 223:17-22 (emphasis added).

[38] *Id.* at 223:24 to 224:1.

Even WorldCom acknowledges in this proceeding that comparing UNE-platform prices to basic residential rates standing alone is meaningless, and that the relevant point of comparison is the *total* retail revenue for *all* services that the CLEC would provide over the UNE platform to a given customer. For that reason, WorldCom includes expected revenues from access, the subscriber line charge, and vertical features (albeit only call waiting) in its comparison.[39] WorldCom's analysis, however, is misleadingly incomplete. For example, WorldCom omits expected revenues for toll services attributable to the purchase of the platform. WorldCom's decision to include only a single vertical feature in its analysis is equally arbitrary; WorldCom should have included the *average* features revenue a carrier receives from a residential customer, or even some broader package of features, since WorldCom can target the customers it wishes to serve and would rationally go after the high end of the market.

But even WorldCom's very incomplete comparison of UNE-platform prices and expected revenues reveals that, in every density zone in New Jersey, the margin between costs and revenues is actually *positive*.[40] WorldCom's complaint, therefore, is not that UNE-platform margins are negative, but rather that they are not so high as to guarantee a lucrative business opportunity for every CLEC seeking to compete through the

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[39] Comments of WorldCom, Inc., Comments Request, filed in CC Docket 01-347 on Jan. 14, 2002 ("WorldCom Comments"), at Attachment A, Declaration of Vijetha Huffman on Behalf of WorldCom, Inc. ("Huffman Declaration") at ¶ 8 and Attachment 1.

[40] *Id.*

platform.[41] As discussed above, nothing in the 1996 Act guarantees that regulatory windfall.

CONCLUSION

For the reasons discussed, the Commission should reject the CLECs' UNE "price squeeze" argument.

41 WorldCom provides no support for its claimed internal costs of $10 per line, *see* WorldCom Comments, Huffman Declaration at ¶ 8, and makes no effort to demonstrate that this level of cost is efficient or even in line with other carriers.

Respectfully submitted,

William T. Lake
Jonathan J. Frankel
William R. Nifong
WILMER CUTLER & PICKERING
2445 M St., N.W.
Washington, DC 20037
(202) 663-6000

Roy Hoffinger
Vice President, Chief Counsel,
Federal and State Regulation
QWEST CORPORATION
1801 California St.
Denver, CO 80202
(303) 992-1400

Attorneys for Qwest Corporation

February 1, 2002

CERTIFICATE OF SERVICE

I, John Meehan, do hereby certify that on this 1st day of February, 2002, true and correct copies of the foregoing Reply Comments of Qwest Corporation will be delivered as indicated to the following parties:

Chairman Michael K. Powell**
Federal Communications Commission
445 12th Street, SW
Room 8-B201
Washington, DC 20554

Commissioner Kathleen Q. Abernathy**
Federal Communications Commission
445 12th Street, SW
Room 8-A204
Washinton, DC 20554

Commissioner Michael J. Copps**
Federal Communications Commission
445 12th Street, SW
Room 8-A302
Washington, DC 20554

Commissioner Kevin J. Martin**
Federal Communications Commission
445 12th Street, SW
Room 8-C302
Washington, DC 20554

Janice Myles** (12 copies)
Policy and Program Planning Division
Common Carrier Bureau
Federal Communications Commission
Room 5-B145
Washington, DC 20554

John M. Lynch*
U.S. Department of Justice
Antitrust Division
Telecommunications Task Force
1401 H Street, NW
Suite 8000
Washington, DC 20530

Anthony Centrella*
Director, Division of Telecommunications
New Jersey Board of Public Utilities
Two Gateway Center, 8th Floor
Newark, NJ 07102

** Hand delivery via messenger

* First class mail, postage prepaid

Michael E. Glover*
Karen Zacharia
Leslie V. Owsley
Donna M. Epps
Joseph DiBella
Verizon
1515 North Courthouse Road
Suite 500
Arlington, VA 22201

Marybeth M. Banks*
H. Richard Juhnke
Sprint Communications Company L.P.
401 9th Street, NW
Suite 400
Washington, DC 20004

Jack Robinson*
President
New Jersey State Grange of the Order of Patrons of Husbandry
164 Woodstown-Daretown Road
Pilesgrove, NJ 08098

Matthew D. Bennett*
Policy Director
Alliance for Public Policy
919 18th Street NW
Suite 800
Washington, DC 20006

Stephen T. Perkins*
Alan M. Shoer
Cavalier Telephone
2134 West Laburnum Avenue
Richmond, VA 23227

Francis R. Perkins*
Meyner and Landis LLP
One Gateway Center
Newark, NJ 07102
Counsel for The New Jersey Cable Telecommunications Association

Dirck A. Hargraves*
Telecommunications Research and Action Center
P.O. Box 27279
Washington, DC 20005

Charles C. Hunter*
Catherine M. Hannan
Hunter Communications Law Group
1424 16th Street, NW
Suite 105
Washington, DC 20006
Counsel for Association of Communications Enterprises

Shaun D. Wiggins*
Keep America Connected!
P.O. Box 27911
Washington, DC 20005

Avril Weisman*
Community Action Partnership
1100 17th Street, NW
Suite 100
Washington, DC 20036

John Cheek*
National Indian Education Association
700 North Fairfax Street
Suite 210
Alexandria, VA 22314

Jonathan E. Canis*
Kelley Drye & Warren LLP
1200 19th Street, NW
Fifth Floor
Washington, DC 20036
Counsel for Z-Tel Communications, Inc.

** Hand delivery via messenger
* First class mail, postage prepaid

Robert Lopardo*
Keith L. Seat
WorldCom, Inc.
1133 19th Street, NW
Washington, DC 20036

Anna Sokolin-Maimon*
Metropolitan Telecommunications
44 Wall Street, 14th Floor
New York, NY 10005

Bruce Kushnick*
Tom Allibone
TeleTruth
826 Broadway
Suite 900
New York, NY 10003

Rodney L. Joyce*
Shook, Hardy & Bacon LLP
600 14th Street, NW
Suite 800
Washington, DC 20005
Counsel for Network Access Solutions Corp.

Blossom A. Peretz*
New Jersey Division of the Ratepayer Advocate
31 Clinton Street – 11th Floor
P.O. Box 46005
Newark, NJ 07101

Connie O. Hughes*
Frederick F. Butler
New Jersey Board of Public Utilities
Two Gateway Center
Newark, NJ 07102

Andrew D. Lipman*
Patrick J. Donovan
Ronald W. Del Sesto, Jr.
Swidler Berlin Shereff Friedman, LLP
3000 K Street, NW
Suite 300
Washington, DC 20007
Counsel for XO Communications, Inc.

Eric J. Branfman*
Edward W. Kirsch
Swidler Berlin Shereff Friedman, LLP
3000 K Street, NW
Suite 300
Counsel for Consolidated Edison Communications, Inc. and *CTC Communications Corp.*

Patrick J. Donovan*
Ronald W. Del Sesto, Jr.
Swidler Berlin Shereff Friedman, LLP
3000 K Street, NW
Suite 300
Washington, DC 20007
Counsel for Conversent Communications Of New Jersey, LLC

Cherie R. Kiser*
James J. Valentino
Catherine Carroll
Angela F. Collins
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.
701 Pennsylvania Avenue, NW
Suite 900
Washington, DC 20004
Counsel for Cablevision Lightpath –NJ, Inc.

** Hand delivery via messenger
* First class mail, postage prepaid

Mark E. Haddad*
David L. Lawson
R. Merinda Wilson
Ronald S. Flagg
Richard E. Young
Sidley Austin Brown & Wood, L.L.P.
1501 K Street, NW
Washington, DC 20005
Counsel for AT&T Corp.

Qualex International**
Portals II
Room CY-B402
445 12th Street, SW
Washington, DC 20554

John Meehan

John Meehan

** Hand delivery via messenger
* First class mail, postage prepaid